A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Office of the Commissioner of Higher Education

For the Two Fiscal Years Ended June 30, 2007

SEPTEMBER 2007

LEGISLATIVE AUDIT
DIVISION

07-20

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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
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James Gillett
Angie Grove

September 2007

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Office of the Commissioner of Higher Education (office) for the two fiscal years ended June 30, 2007. This report contains six recommendations where the office should improve compliance with state and federal laws and regulations. The written response to the audit recommendations is included at the end of the audit report.

We thank the commissioner and her staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Appointed and Administrative Officials

			Term Expires
Board of Regents of Higher Education	Lynn Morrison-Hamiliton, Chair	Havre	Feb. 1, 2013
	Stephen M. Barrett, Vice Chair	Bozeman	Feb. 1, 2012
	Todd Buchanan	Billings	Feb. 1, 2014
	Clayton Christian	Missoula	Feb. 1, 2008
	Kerra Melvin, Student Regent	Butte	June 30, 2008
	Dr. Janine Pease	Billings	Feb. 1, 2011
	Lila Taylor	Busby	Feb. 1, 2010
	Brian Schweitzer, Governor*		
	Sheila Stearns, Commissioner of Higher Education*		
	Linda McCulloch, Superintendent of Public Instruction*		
	*Ex officio Member		

Commissioner of Higher Education	Sheila M. Stearns, Ed. D	Commisioner of Higher Education
	Roger Barber	Deputy Commissioner for Academic and Student Affairs
	Mick Robinson	Associate Commissioner for Fiscal Affairs
	Frieda Houser	Director, Budget and Accounting
	Tyler Trevor	Associate Commissioner for Research, Technology and Communication

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Report Summary

Office of the Commissioner of Higher Education

We performed a financial-compliance audit of the Office of the Commissioner of Higher Education (office) for the two fiscal years ended June 30, 2007. The prior audit report contained two recommendations. The office implemented one recommendation and partially implemented one recommendation. The office has not complied with state law regarding indirect costs, discussed further on page 7. The six recommendations in this report relate to compliance with state and federal laws and regulations.

We issued a qualified opinion on the financial schedules contained in this report. The Independent Auditor's Report on page A-3 and Recommendation #2 on page 7 discuss misstatements on the office's financial schedules. The reader should use caution when relying on the financial information presented and the supporting information on the state's accounting system.

The listing below serves as a means of summarizing the recommendations contained in the report, the office's response thereto, and a reference to the supporting comments.

<ins>Recommendation #1</ins>
We recommend the office maintain the Group Insurance Plan reserve based on sound actuarial principles or other applicable criteria in accordance with federal regulations. ...6

Office Response: Do not concur B-4

<ins>Recommendation #2</ins>
We recommend the office record the Montana Family Education Savings Program activity on its accounting records in accordance with generally accepted accounting principles...7

Office Response: Concur..B-5

<ins>Recommendation #3</ins>
We recommend the office:

A. Recover indirect costs to the fullest extent possible in accordance with state law.

B. Record indirect cost recoveries in the appropriate fund and account in accordance with state law.

C. Obtain approval from the Board of Regents prior to accepting grants that limit the office's ability to recover indirect costs in accordance with state law...................8

Office Response: Concur:..B-5

Chapter I — Introduction

Introduction

We performed a financial-compliance audit of the Office of the Commissioner of Higher Education (office) for the two fiscal years ended June 30, 2007. The objectives of our audit were to:

1. Determine the office's and the Board of Regents' compliance with applicable state and federal laws and regulations.
2. Obtain an understanding of the office's internal control to the extent necessary to support our audit of the financial schedules and, if necessary, make recommendations for improvements in the office's management and internal controls.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the office's financial schedules are fairly presented for the two fiscal years ended June 30, 2007.

The Montana Guaranteed Student Loan Program, which is part of the office, allows eligible students to receive guaranteed loans from lending institutions for post-secondary education. The program is audited annually by our office. Recommendations identified during the course of those audits are included in this report.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations made in this report. Areas of concern deemed not to have significant effect on the successful operations of the office are not specifically included in the report, but have been discussed with management.

Background

Board of Regents of Higher Education

Article X of the Montana Constitution establishes the Board of Regents of Higher Education (board) to govern and control the Montana University System. The board has administrative and supervisory control of the units of the university system and general supervision of community colleges. The board consists of seven members appointed by the governor and confirmed by the Senate. The governor, the commissioner of higher education, and the superintendent of public instruction are ex officio members of the board.

Office of the Commissioner of Higher Education

As required by Article X of the Montana Constitution, the board appoints a Commissioner of Higher Education. The board prescribes the term and duties of the commissioner. The commissioner is responsible for providing leadership, technical assistance, and staff support to the board and the units of the university system. Duties of the commissioner include academic planning and curriculum review, budgetary planning and control, legal services, and labor negotiation policies and procedures. Total authorized full-time equivalent (FTE) staff for the office was 105.55 during the audit period. This includes 19.4 FTE funded by the General Fund for general administration and operations, 3.75 FTE funded by the Enterprise Fund for the Montana University System (MUS) group health insurance and workers' compensation programs, 25.2 FTE for federal grant operations, and 57.2 FTE are for the Montana Guaranteed Student Loan Program. The office conducts its operations in the following programs:

Administration Program - provides general administration for all the duties of the office. This includes academic, student assistance, financial, and legal administration as well as labor relations and personnel administration.

Board of Regents Administration - consists of the costs associated with the operation of the board.

Student Assistance Program - consists of the Western Interstate Commission on Higher Education (WICHE) Student Exchange Program; the Washington, Wyoming, Alaska, Montana, Idaho (WWAMI) Cooperative Medical Program; the Leveraging Educational Assistance Partnership (LEAP) Program; the Perkins Loan Fund Match Program; state matching dollars for the federal Supplemental Education Opportunity Grant (SEOG); the Montana Work Study Program; the Montana Tuition Assistance Program (MTAP); the Governor's Scholarship Program; and the Baker Grants.

Guaranteed Student Loan Program - processes loan applications, maintains records on student borrowers, warehouses records, collects loan payments and performs other duties related to the Federal Family Education Loan Program (FFELP). It also includes the administration of the Governor's Scholarship Program and the Montana Family Education Savings Program.

MUS Group Insurance Program - accounts for all activity related to the Montana University System employee benefits program and flexible spending plan.

Work Force Development Program - supports vocational education at the secondary and post secondary level. The office is designated as the sole state agency for the federal Vocational Education - Basic Grants to States. Amounts used at the secondary level are subgranted to the Office of Public Instruction.

Improving Teacher Quality (formerly called Dwight D. Eisenhower Mathematics & Science Education Act) - is a federal program that provides funds to upgrade the teaching skills of teachers in the mathematics and science disciplines. Grants are awarded to institutions of higher education within the state on a competitive basis.

Talent Search - is a federally funded program to provide career and financial aid counseling to selected students. It includes General Fund support for an American Indian/Minority Achievement Program. It also includes the federally funded Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant.

Appropriation Distribution - accounts for the distribution of the state's General Fund and millage appropriations to the university units.

Community College Assistance - accounts for the distribution of the state's assistance to the three community colleges.

Tribal College Assistance Program - accounts for the distribution of the state's assistance to the tribal colleges.

MUS Workers Compensation Program - accounts for all activity related to the Montana University System's self-funded workers' compensation program.

Private-Purpose Trust Fund - accounts for the Montana Family Education Savings Program (MFESP) activity.

Prior Audit Recommendations

We performed the audit of the Office of the Commissioner of Higher Education for the two fiscal years ended June 30, 2005. The 2005 report contained two recommendations. The office implemented one recommendation and partially implemented one recommendation. The office has not complied with state law regarding indirect costs, which is discussed further on page 7.

Chapter II — Findings and Recommendations

MUS Group Insurance Reserves

The office was unable to provide documentation showing the Montana University System (MUS) Group Insurance Plan rates and the reserve level generated are based on sound actuarial principles.

The MUS Group Insurance Plan is a self-insurance program that provides health coverage to the office, the Montana State University and The University of Montana campuses, the community colleges, and affiliates. Premiums are funded with state and federal funding sources. Section 20-25-1310, MCA, states the office shall maintain the plan on an actuarially sound basis and maintain reserves sufficient to liquidate the unrevealed claims liability and other liabilities of the group benefits plan. Federal regulations specify that contributions to self-insurance reserves are allowable if the contributions are based on sound actuarial principles, using historical experience and reasonable assumptions. These regulations also specify the reserve levels must be analyzed and updated at least biennially. Alternatively, federal regulations provide that contributions to a reserve for an approved self-insurance plan are an allowable cost to the extent the coverage and rates would have been allowed had insurance been purchased to cover the risks.

The office contracted with an actuary to estimate the MUS Group Insurance Plan incurred but not reported (IBNR) liability as of June 30, 2006, and 2007, and to aid the office in its rate setting process. As part of this rate setting process, the office analyzes how a given rate level will affect the current plan reserve level. However, the office does not have documentation demonstrating the rates which generated reserve levels of $22,752,039 and $23,925,412 at June 30, 2006, and 2007, respectively, are based on sound actuarial principles or other applicable criteria in accordance with federal regulations. Without this documentation, the portion paid by federal funds may not be allowable charges to federal programs. We estimate $2,868,210 of the MUS Group Insurance Plan reserve as of June 30, 2007, may be unallowable.

Office personnel believe their background and history with group insurance gives them the knowledge needed to determine an appropriate level of reserve. While we agree the office has experienced staff, we cannot presume the current staff has the necessary qualifications or expertise to address the requirements of state and federal law. The office should ensure the documentation supporting its rates and reserves demonstrates compliance with federal regulations.

Recommendation #1

We recommend the office maintain the Group Insurance Plan reserve based on sound actuarial principles or other applicable criteria in accordance with federal regulations.

Montana Family Education Savings Program (MFESP)

The office did not record the MFESP assets on the state's accounting records in accordance with generally accepted accounting principles.

The state of Montana offers a MFESP as a way for families to save for post-secondary education costs. Participants contribute money to an account, which is invested at the direction of the account holder. The interest earnings are accumulated on a tax-free basis as long as the funds are withdrawn and used for qualifying education expenses. The accumulation of these individual accounts make up the Family Education Savings Trust (trust). Section 20-25-902, MCA, designates the Board of Regents as the trustee of the trust. Although the office has contracted with an outside vendor to manage the trust, this contract does not relieve the office of its trustee status. Therefore the activity and balances associated with the MFESP should be recorded on the state's accounting records.

As of June 30, 2006, the office had not recorded the MFESP on the state's accounting records. Office personnel indicated the MFESP was not recorded because the office does not actually administer the program itself and has no claim to the assets. Accounting principles state the Private-Purpose Trust Fund should be used to report trust arrangements under which principal and income benefit individuals, private organizations, or other governments.

During fiscal year 2006-07, after we brought this issue to their attention, office personnel recorded the MFESP assets and Property Held in Trust on the state's accounting records in a Private-Purpose Trust Fund. Generally accepted accounting principles require additions and reductions of a Private-Purpose Trust Fund to be recorded as revenues and expenses.

Because of the method used by the office to record the MFESP assets, the Private-Purpose Trust Fund balance is understated by $205,558,491 at June 30, 2007, and the MFESP revenues and expenses activity are not reported on the office's fiscal year 2006-07 financial schedules. As of August 2007, the detail of contributions and distributions made and interest earned during fiscal years 2005-06 and 2006-07, as well as the value of the assets

as June 30, 2006, was not available. Therefore we were unable to determine the actual impact on revenues and expenses for these two fiscal years.

Recommendation #2
We recommend the office record the Montana Family Education Savings Program activity on its accounting records in accordance with generally accepted accounting principles.

Indirect Cost Activity

The office is not charging and accounting for indirect costs related to its federal awards in accordance with state law.

The office administers federal grants to finance a portion of its program activities. These programs include, but are not limited to, the Guaranteed Student Loan Program, Vocational Education – Basic Grants to States, GEAR UP, and Talent Search. As part of this assistance, the office receives funding for costs incurred in administering the various programs through the use of indirect cost rates. These rates can be predetermined, restricted to recovery of selected cost elements, or unrestricted, depending on the federal assistance program.

The office's approved restricted rates were 2.8 percent and 2.9 percent and its unrestricted rates were 12.7 percent and 16 percent for fiscal years 2005-06 and 2006-07, respectively. While the office received financial assistance for federal programs under each of the indirect cost rates listed above, it applied its restricted rate to all of its federal awards. Section 17-1-106(3), MCA, states an agency may not waive or otherwise forfeit the agency's ability to recover indirect costs that are otherwise allowable costs under the program. By charging the restricted rate to all federal awards, the office did not recover indirect costs of $672,825 in fiscal year 2005-06 and $803,991 in fiscal year 2006-07.

In fiscal year 2005-06, the office began using an indirect cost pool to account for the indirect costs related to the restricted rate, as well as the related indirect cost recoveries. The indirect costs incurred in excess of recoveries from the restricted rate were paid from the General Fund. Section 17-1-106(3), MCA, states when indirect cost recoveries are limited by the grant through regulation, policy, or guideline, indirect costs paid originally from the General Fund must be claimed and reimbursed first. Therefore, when the office received indirect cost recoveries it should have reimbursed the General Fund for the indirect costs it

paid prior to reimbursing the indirect cost pool. We estimate the loss to the General Fund to be $672,654 for fiscal year 2005-06 and $694,213 for fiscal year 2006-07.

Section 17-1-106(2), MCA, further requires agencies that apply for, or otherwise receive funds through, federal grants that do not allow it to fully recover indirect costs to notify, and receive written approval from, its approving authority prior to accepting the funds. Because the office received grant awards that restricted the recovery of indirect costs to an amount less than the approved unrestricted indirect cost rate, it should have notified and received approval from the Board of Regents.

Fiscal year 2005-06 was the first year the office actually obtained approved indirect cost rates and began using an indirect cost pool. Office personnel indicated they are still working through and learning the processes and procedures related to this type of activity and believe they will continue to improve in this area as they move forward.

Recommendation #3

We recommend the office:

A. Recover indirect costs to the fullest extent possible in accordance with state law.

B. Record indirect cost recoveries in the appropriate fund and account in accordance with state law.

C. Obtain approval from the Board of Regents prior to accepting grants that limit the office's ability to recover indirect costs in accordance with state law.

State Indirect Cost Recoveries

The office is not charging indirect costs to the Rural Physicians Incentive Program in accordance with state law.

The state of Montana participates in a cooperative program with Washington, Wyoming, Alaska, and Idaho, that allows students to attend the University of Washington School of Medicine at in-state tuition rates. The office charges an eight percent fee to Montana students who participate in this program. These fees are then used by the Rural Physicians Incentive Program to recruit physicians to medically underserved areas within the state. The Rural Physicians Incentive Program helps pay the education debts of qualifying physicians who work within the underserved areas.

Section 20-26-1503, MCA, allows the office to use up to ten percent of the fees collected for administration of the Rural Physicians Incentive Program. Office personnel indicated they have not used any of these fees for administration of the program to date. These administrative costs are paid from the office's General Fund appropriation. Section 17-1-106, MCA, states when indirect cost recoveries are limited by the grant through regulation, policy, or guideline, indirect costs paid originally from the General Fund must be claimed and reimbursed first. We estimate the loss to the General Fund to be $6,096 for fiscal years 2005-06 and 2006-07.

Recommendation #4

We recommend the office pay the indirect costs of the Rural Physicians Incentive Program from the fees collected in accordance with state law.

GEAR UP Investment Activity

The office has not invested the GEAR UP Scholarship funds with the Montana Board of Investments (BOI) in accordance with state law.

The office receives federal and private financial assistance for the GEAR UP programs. As part of these programs, the office selects eligible students to receive scholarship funds for post-secondary education. The students are generally in eighth grade when determined eligible. The office invests the scholarship funds with the Family Education Savings Program (MFESP) until the students go to college and are eligible to receive the scholarship funds. The office had $2,113,952 and $3,406,306 at June 30, 2006, and 2007, respectively, of GEAR UP funds invested within the MFESP.

Section 17-6-201, MCA, specifies the BOI has the primary authority to invest state funds. Another agency may not invest state funds unless otherwise provided by law. The office does not have authority within state law to invest GEAR UP funds. Therefore, these funds should be invested through the BOI instead of the MFESP. Office personnel indicated at the time these investments were originally made, it was their understanding if the funds were invested with the state it would put the program funding at risk. However, it has since been determined this is not the case and office personnel said they will work towards moving these investments to the BOI as they mature.

Recommendation #5

We recommend the office invest the GEAR UP funds with the Board of Investments in accordance with state law.

Cash Management

The office did not request federal cash in accordance with federal regulations.

The office received Workforce Investment Act Pilots, Demonstrations, and Research Project grant funds from the Department of Labor and Industry beginning in June 2006. Federal regulations require the office to request federal funds on a reimbursement basis and minimize the time between the draw of funds from the federal government and their disbursement for federal program purposes. To comply, the office should limit each draw to the minimum amount needed and time the draw to coincide with actual, immediate cash disbursements for federal program costs.

We noted four instances where the office drew federal cash in excess of its needs, resulting in positive cash balances for periods of four to eleven weeks ranging from $19,792 to $35,298. A fifth instance occurred on June 21, 2007, resulting in a positive cash balance of $95,943 as of June 30, 2007. Office personnel indicated they had not received guidance from the Department of Labor and Industry on the amount and timing of draws and had not realized they were not complying with federal regulations. They said they would begin drawing in compliance with federal regulations immediately.

Recommendation #6

We recommend the office minimize the time between the draw of federal funds and their disbursement for federal program purposes as required by federal regulations.

Chapter III — Disclosure Issue

Montana Guaranteed Student Loan Program

The Montana Guaranteed Student Loan Program (MGSLP), also known as the Federal Family Education Loan Program, was established by the Montana Board of Regents on July 1, 1980. The MGSLP allows eligible students to receive loans from lending institutions to pay for post-secondary education. The federal government guarantees the loans made by the lending institutions and makes administrative cost reimbursements to MGSLP for acting as a collection agent. Federal regulations specify these administrative cost reimbursements are considered the property of the guaranty agency. The funds are restricted for use on guaranty agency related activities, or other student financial aid-related activities for the benefit of students, as selected by the guaranty agency. Since its inception, the MGSLP as administered by the office has grown and diversified. We have identified the following issues that may be indicative of a need for a more in-depth legislative review.

MGSLP Resources used for Student Assistance Program Activities

Two of the programs within the office are the MGSLP as discussed above, and the Student Assistance Program. While the MGSLP guarantees student loans made by private lenders to students for post-secondary education expenses, the Student Assistance Program consists of grant, loan, and work study programs, as well as the interstate student exchange and assistance programs. Therefore, both programs help students obtain financial assistance for post-secondary education expenses.

The 2005 Legislature approved federal special revenue fund appropriation authority for MGSLP activities only. While the legislature acknowledged MGSLP personnel would administer the Governor's Scholarship Program, the appropriation authority for this activity was within the Student Assistance Program. However, the office has tasked MGSLP personnel with Student Assistance Program duties in addition to the Governor's Scholarship Program. These duties include:

- Scholarships to students
- Montana Family Education Savings Program
- Montana University System Honors Scholarship Program
- Various GEAR UP program expenses
- Various other Montana grant programs

At the end of each fiscal year, the MGSLP staff submits a bill for these Student Assistance Program support activities to the office Fiscal Affairs Division personnel. The office

reimburses the MGSLP up to the appropriation authority it has within the Student Assistance Program for those costs. However, the appropriations are not enough to cover the costs of the administrative support provided. We estimate the unreimbursed amounts paid by MGSLP from its federal special revenue fund were $789,731 in fiscal year 2005-06 and $916,739 in fiscal year 2006-07 for Student Assistance Program activities.

While the Student Assistance Program activities financed by the MGSLP are allowable costs per federal regulations, the presentation of these activities within the MGSLP expenditure program can be misleading. The Schedules of Total Expenditures & Transfers-Out shown on pages A-9 and A-10 present office expenditure activity by program. Because the Student Assistance Program appropriation is insufficient to cover the costs of the program, it appears the MGSLP costs more and the Student Assistance Program costs less to administer than they actually do.

Expenditure of non-General Fund Money First

The office's continued and increased use of MGSLP assets for Student Assistance Program activities is an indication of non-compliance with section 17-2-108(1), MCA, which requires the use of non-General Fund money whenever possible before using General Fund appropriations. The MGSLP had $1,509,591 and $3,866,704 of unspent budget authority at the end of fiscal years 2005-06 and 2006-07, respectively.

As discussed in the previous section, the office used General Fund appropriations to reimburse MGSLP for a portion of the administration costs of selected programs. Compliance with 17-2-108(1), MCA, may make this reimbursement inappropriate.

MGSLP Fund Placement

We believe there is a conflict between sections 20-26-1105, MCA, and 17-2-102, MCA. Section 20-26-1105, MCA, specifies there is a student loan account within the federal special revenue fund provided for in 17-2-102, MCA, which establishes the state's fund structure. According to this statute, the federal special revenue fund should consist of money from federal sources that is used for the operations of state government. We estimate 25.1 percent of MGSLP revenues for fiscal year 2005-06 and 23.8 percent for fiscal year 2006-07 were received from non-federal sources and, therefore, should not be recorded in the federal special revenue fund.

The office receives administrative cost reimbursements from the federal government. These are considered the property of the guaranty agency. Although these reimbursements are properly deposited in the federal special revenue fund, there is no requirement they remain in that fund for expenditure. These monies could be transferred to the state special revenue or enterprise fund.

The office should consider discussing the fund placement with the Department of Administration as section 17-2-106, MCA, designates it as the agency that may create new funds, consistent with the fund structure within section 17-2-102, MCA. These discussions may lead to a need for legislative change.

We present these issues for disclosure purposes only and make no recommendation at this time.

Independent Auditor's Report & Office Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor

Deputy Legislative Auditors:
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedule of Changes in Fund Balances & Property Held in Trust, Schedule of Changes in Fund Balances, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Office of the Commissioner of Higher Education for each of the fiscal years ended June 30, 2007, and 2006. The information contained in these financial schedules is the responsibility of the office's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the office's assets, liabilities and cash flows.

The office did not record the Montana Family Education Savings Program (MFESP) assets in a Private-Purpose Trust Fund on the state's accounting records as of June 30, 2006, and made errors in recording the assets during fiscal year 2006-07. As a result, the MFESP activity is not reported on the fiscal year 2005-06 and 2006-07 financial schedules. The Private-Purpose Trust Fund balance is understated by $205,558,491

as of June 30, 2007. It was not practical for us to determine the misstatements of revenues and expenses for the two fiscal years of the audit period.

In our opinion, except for the effects of the matter discussed in the preceding paragraph, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Office of the Commissioner of Higher Education for each of the fiscal years ended June 30, 2007, and 2006, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

August 22, 2007

COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Agency Fund
FUND BALANCE: July 1, 2006	$ (1,706,554)	$ 1,639,074	$ 14,227,873	$ 23,730,475	$ 0
PROPERTY HELD IN TRUST: July 1, 2006					$ 0
ADDITIONS					
Budgeted Revenues & Transfers-In	984,130	353,778	43,511,173	68,523,430	
Nonbudgeted Revenues & Transfers-In	663	92,123	38,693	97	(760)
Prior Year Revenues & Transfers-In Adjustments	6,917	8,575	(20,539)	(25,261)	760
Direct Entries to Fund Balance	156,340,424	16,775,127	4,307	20,119	
Total Additions	157,332,134	17,229,603	43,533,634	68,518,385	0
REDUCTIONS					
Budgeted Expenditures & Transfers-Out	155,719,507	15,520,550	41,100,980	65,180,824	
Nonbudgeted Expenditures & Transfers-Out		55,006		32,843	
Prior Year Expenditures & Transfers-Out Adjustments		3,750	(2,681)	(26,486)	
Total Reductions	155,719,507	15,579,306	41,098,299	65,187,181	0
FUND BALANCE: June 30, 2007	$ (93,927)	$ 3,289,371	$ 16,663,208	$ 27,061,679	$ 0
PROPERTY HELD IN TRUST: June 30, 2007					

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund
FUND BALANCE: July 1, 2005	$ (530,065)	$ 787,466	$ 13,196,907	$ 19,208,068
ADDITIONS				
Budgeted Revenues & Transfers-In	944,963	463,091	40,043,143	63,410,709
NonBudgeted Revenues & Transfers-In	788	115,558	36,631	172
Prior Year Revenues & Transfers-In Adjustments	1,359	628	18,250	40,339
Direct Entries to Fund Balance	152,089,232	15,521,988	58	23,000
Total Additions	153,036,342	16,101,265	40,098,082	63,474,220
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	154,236,313	15,188,247	39,082,637	58,980,522
NonBudgeted Expenditures & Transfers-Out		60,369		(20,269)
Prior Year Expenditures & Transfers-Out Adjustments	(23,482)	1,041	(15,521)	(8,440)
Total Reductions	154,212,831	15,249,657	39,067,116	58,951,813
FUND BALANCE: June 30, 2006	$ (1,706,554)	$ 1,639,074	$ 14,227,873	$ 23,730,475

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Agency Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS						
Taxes	$ 991,710	$ 10,162	$ 1,289	$ 87		$ 1,003,248
Charges for Services		327,644	30,182,128	4,047,323		34,557,095
Investment Earnings		34,809	675,696	1,859,924		2,570,429
Fines, Forfeits and Settlements				9,864		9,864
Contributions and Premiums				61,369,305		61,369,305
Miscellaneous				587,316		587,316
Grants, Contracts, Donations and Abandonments		81,861				81,861
Other Financing Sources			1,790,540			1,790,540
Federal			10,541,806	624,447		11,166,253
Federal Indirect Cost Recoveries			337,868			337,868
Total Revenues & Transfers-In	991,710	454,476	43,529,327	68,498,266	0	113,473,779
Less: Nonbudgeted Revenues & Transfers-In	663	92,123	38,693	97	$ (760)	130,816
Prior Year Revenues & Transfers-In Adjustments	6,917	8,575	(20,539)	(25,261)	760	(29,548)
Actual Budgeted Revenues & Transfers-In	984,130	353,778	43,511,173	68,523,430	0	113,372,511
Estimated Revenues & Transfers-In	1,071,459	551,000	50,554,939	79,032,874		131,210,272
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (87,329)	$ (197,222)	$ (7,043,766)	$ (10,509,444)	$ 0	$ (17,837,761)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS						
Licenses and Permits		$ (51,000)				$ (51,000)
Taxes	$ (47,744)					(47,744)
Charges for Services	(84)	(45,931)	$ (3,025,129)	$ 72,498		(2,998,646)
Investment Earnings		34,709	231,756	1,259,914		1,526,379
Fines, Forfeits and Settlements				13		13
Contributions and Premiums				(12,028,632)		(12,028,632)
Miscellaneous				437,316		437,316
Other Financing Sources		(135,000)	(1,102,892)			(1,237,892)
Federal			(3,260,369)	(250,553)		(3,510,922)
Federal Indirect Cost Recoveries	(39,501)		112,868			73,367
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (87,329)	$ (197,222)	$ (7,043,766)	$ (10,509,444)	$ 0	$ (17,837,761)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS					
Taxes	$ 947,110	$ 14,641	$ 1,217	$ 70	$ 963,038
Charges for Services		366,007	29,686,103	3,543,373	33,595,483
Investment Earnings		24,371	492,172	1,262,464	1,779,007
Contributions and Premiums				58,137,061	58,137,061
Miscellaneous				508,252	508,252
Grants, Contracts, Donations and Abandonments		40,523			40,523
Other Financing Sources		133,735	336,600		470,335
Federal			9,361,499		9,361,499
Federal Indirect Cost Recoveries			220,433		220,433
Total Revenues & Transfers-In	947,110	579,277	40,098,024	63,451,220	105,075,631
Less: Nonbudgeted Revenues & Transfers-In	788	115,558	36,631	172	153,149
Prior Year Revenues & Transfers-In Adjustments	1,359	628	18,250	40,339	60,576
Actual Budgeted Revenues & Transfers-In	944,963	463,091	40,043,143	63,410,709	104,861,906
Estimated Revenues & Transfers-In	966,194	404,735	63,172,124	66,909,803	131,452,856
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (21,231)	$ 58,356	$ (23,128,981)	$ (3,499,094)	$ (26,590,950)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS					
Licenses and Permits		$ (26,000)			$ (26,000)
Taxes	$ 18,128				18,128
Charges for Services	(84)	59,986	$ (20,422,152)	$ 132,567	(20,229,683)
Investment Earnings		24,370	311,019	787,997	1,123,386
Contributions and Premiums				(4,739,962)	(4,739,962)
Miscellaneous				320,304	320,304
Other Financing Sources			(322,550)		(322,550)
Federal			(2,693,731)		(2,693,731)
Federal Indirect Cost Recoveries	(39,275)		(1,567)		(40,842)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (21,231)	$ 58,356	$ (23,128,981)	$ (3,499,094)	$ (26,590,950)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Administration Program	Appropriation Distribution	Board of Regents Administration	Community College Assistance	Guaranteed Student Loan Program	Improving Teacher Quality	MUS Group Insurance Program	MUS Workers Compensation Program	Student Assistance Program	Talent Search	Tribal College Assistance Program	Work Force Development Program	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT													
Personal Services													
Salaries	$ 1,589,175				$ 1,602,984	$ 11,515	$ 144,003	$ 3,577	$ 47,000	$ 528,645		$ 261,247	$ 4,188,146
Other Compensation	4,900		$ 3,000										7,900
Employee Benefits	354,653				622,496	3,435	43,679	847		192,000		76,762	1,293,872
Personal Services-Other							4,243	3,238					7,481
Total	1,948,728		3,000		2,225,480	14,950	191,925	7,662	47,000	720,645		338,009	5,497,399
Operating Expenses													
Other Services	220,668	$ 7	297		2,173,442		3,615,370	463,745		167,444		40,078	6,681,051
Supplies & Materials	34,845		3,207		96,486	447	49,317	1,457		58,216		10,901	254,876
Communications	35,989		177		230,682	331	8,759	2,651		15,366		7,348	301,303
Travel	38,632		18,341		170,554		7,661			170,158		54,534	459,880
Rent	140,641				130,751		16,896			30,801		17,534	336,623
Utilities					22,216								22,216
Repair & Maintenance	10,899				16,431		1,344			417		98	29,189
Other Expenses	50,144		8,138		1,489,238	1,094	590,809	36,734		441,952		27,187	2,645,296
Total	531,818	7	30,160		4,329,800	1,872	4,290,156	504,587		884,354		157,680	10,730,434
Equipment & Intangible Assets													
Equipment	(314)				39,290								38,976
Total	(314)				39,290								38,976
Local Assistance													
From State Sources	11,500			$ 6,958,390					112,000				7,081,890
Total	11,500			6,958,390					112,000				7,081,890
Grants													
From State Sources									10,353,557		$ 1,420,001		11,773,558
From Federal Sources						291,790				1,369,115		2,523,499	4,184,404
From Other Sources									155,870				155,870
Total						291,790			10,509,427	1,369,115	1,420,001	2,523,499	16,113,832
Benefits & Claims													
To Individuals								2,101,587					2,101,587
Insurance Payments					22,947,023		58,057,733						81,004,756
Total					22,947,023		58,057,733	2,101,587					83,106,343
Transfers													
Accounting Entity Transfers					37,400					1,487,871		3,398,526	4,923,797
Intra-Entity Expense	40,000	150,018,091											150,058,091
Total	40,000	150,018,091			37,400					1,487,871		3,398,526	154,981,888
Debt Service													
Bonds								33,531					33,531
Total								33,531					33,531
Total Expenditures & Transfers-Out	$ 2,531,732	$ 150,018,098	$ 33,160	$ 6,958,390	$ 29,578,993	$ 308,612	$ 62,539,814	$ 2,647,367	$ 10,668,427	$ 4,461,985	$ 1,420,001	$ 6,417,714	$ 277,584,293
EXPENDITURES & TRANSFERS-OUT BY FUND													
General Fund	$ 2,194,972	$ 134,692,547	$ 33,160	$ 6,958,390					$ 10,265,047	$ 65,299	$ 1,420,001	$ 90,091	$ 155,719,507
State Special Revenue Fund		15,325,551							180,870	72,885			15,579,306
Federal Special Revenue Fund	336,760				$ 29,578,993	$ 308,612			222,510	4,323,801		6,327,623	41,098,299
Enterprise Fund							$ 62,539,814	$ 2,647,367					65,187,181
Total Expenditures & Transfers-Out	2,531,732	150,018,098	33,160	6,958,390	29,578,993	308,612	62,539,814	2,647,367	10,668,427	4,461,985	1,420,001	6,417,714	277,584,293
Less: Nonbudgeted Expenditures & Transfers-Out		7					29,605	3,238		55,000			87,850
Prior Year Expenditures & Transfers-Out Adjustments					(2,681)		(29,718)	3,232	3,750				(25,417)
Actual Budgeted Expenditures & Transfers-Out	2,531,732	150,018,091	33,160	6,958,390	29,581,674	308,612	62,539,927	2,640,897	10,664,677	4,406,985	1,420,001	6,417,714	277,521,860
Budget Authority	2,765,276	152,159,698	60,570	8,764,880	41,168,876	462,201	65,891,087	3,465,300	10,912,105	4,831,429	1,420,003	10,063,194	301,964,619
Unspent Budget Authority	$ 233,544	$ 2,141,607	$ 27,410	$ 1,806,490	$ 11,587,202	$ 153,589	$ 3,351,160	$ 824,403	$ 247,428	$ 424,444	$ 2	$ 3,645,480	$ 24,442,759
UNSPENT BUDGET AUTHORITY BY FUND													
General Fund	$ 193,704	$ 2,140,607	$ 27,410	$ 1,806,490					$ 171,657	$ 16,893	$ 2	$ 12,493	$ 4,369,256
State Special Revenue Fund		1,000							72,508	32,115			105,623
Federal Special Revenue Fund	39,840				$ 11,587,202	$ 153,589			3,263	375.436		3,632,987	15,792,317
Enterprise Fund							$ 3,351,160	$ 824,403					4,175,563
Unspent Budget Authority	$ 233,544	$ 2,141,607	$ 27,410	$ 1,806,490	$ 11,587,202	$ 153,589	$ 3,351,160	$ 824,403	$ 247,428	$ 424,444	$ 2	$ 3,645,480	$ 24,442,759

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

COMMISSIONER OF HIGHER EDUCATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Administration Program	Appropriation Distribution	Board of Regents Administration	Community College Assistance	Guaranteed Student Loan Program	Improving Teacher Quality	MUS Group Insurance Program	MUS Workers Compensation Program	Student Assistance Program	Talent Search	Tribal College Assistance Program	Work Force Development Program	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT													
Personal Services													
Salaries	$ 1,362,888				$ 1,450,750	$ 9,273	$ 214,709		$ 46,662	$ 554,511		$ 211,924	$ 3,850,717
Other Compensation			$ 2,900										2,900
Employee Benefits	293,715				543,652	3,413	120,394			201,259		59,989	1,222,422
Personal Services-Other							(43,227)						(43,227)
Total	1,656,603		2,900		1,994,402	12,686	291,876		46,662	755,770		271,913	5,032,812
Operating Expenses													
Other Services	185,917	$ 51,256	847		3,429,875	1,809	3,263,303	$ 386,678		90,198		12,353	7,422,236
Supplies & Materials	40,844	1,019	10,090		83,391	1,746	37,349			58,545		21,001	253,985
Communications	32,486	710			243,046	175	7,185			16,895		5,165	305,662
Travel	38,488	1,425	13,609		152,891		3,949		338	158,312		41,179	410,191
Rent	106,611		459		123,068	543	16,713			29,462		18,871	295,727
Utilities	7,155				29,025								36,180
Repair & Maintenance	15,412				17,501		1,199			652		90	34,854
Other Expenses	51,344		495		1,130,303	783	445,745	30,121		306,716		93,124	2,058,631
Total	478,257	54,410	25,500		5,209,100	5,056	3,775,443	416,799	338	660,780		191,783	10,817,466
Equipment & Intangible Assets													
Equipment	11,243				7,499								18,742
Total	11,243				7,499								18,742
Local Assistance													
From State Sources				$ 8,585,919					108,000				8,693,919
Total				8,585,919					108,000				8,693,919
Grants													
From State Sources									9,539,892		$ 1,479,998		11,019,890
From Federal Sources						344,807				1,048,179		2,712,102	4,105,088
From Other Sources									201,473				201,473
Total						344,807			9,741,365	1,048,179	1,479,998	2,712,102	15,326,451
Benefits & Claims													
To Individuals								2,508,479					2,508,479
Insurance Payments					21,967,241		51,913,393						73,880,634
Total					21,967,241		51,913,393	2,508,479					76,389,113
Transfers													
Accounting Entity Transfers					36,600					300,000		3,276,045	3,612,645
Intra-Entity Expense		147,544,446											147,544,446
Total		147,544,446			36,600					300,000		3,276,045	151,157,091
Debt Service													
Bonds								45,823					45,823
Total								45,823					45,823
Total Expenditures & Transfers-Out	$ 2,146,103	$ 147,598,856	$ 28,400	$ 8,585,919	$ 29,214,842	$ 362,549	$ 55,980,712	$ 2,971,101	$ 9,896,365	$ 2,764,729	$ 1,479,998	$ 6,451,843	$ 267,481,417
EXPENDITURES & TRANSFERS-OUT BY FUND													
General Fund	$ 1,925,088	$ 132,582,672	$ 28,400	$ 8,585,919					$ 9,436,977	$ 82,685	$ 1,479,998	$ 91,092	$ 154,212,831
State Special Revenue Fund		15,016,184							226,473	7,000			15,249,657
Federal Special Revenue Fund	221,015				$ 29,214,842	$ 362,549			232,915	2,675,044		6,360,751	39,067,116
Enterprise Fund							$ 55,980,712	$ 2,971,101					58,951,813
Total Expenditures & Transfers-Out	2,146,103	147,598,856	28,400	8,585,919	29,214,842	362,549	55,980,712	2,971,101	9,896,365	2,764,729	1,479,998	6,451,843	267,481,417
Less: Nonbudgeted Expenditures & Transfers-Out	0	53,369					(20,269)			7,000			40,100
Prior Year Expenditures & Transfers-Out Adjustment	(19,955)	1,041			(7,786)		(2,150)	(6,289)	(3,527)	(4,258)		(3,476)	(46,400)
Actual Budgeted Expenditures & Transfers-Out	2,166,058	147,544,446	28,400	8,585,919	29,222,628	362,549	56,003,131	2,977,390	9,899,892	2,761,987	1,479,998	6,455,319	267,487,717
Budget Authority	2,488,656	150,400,579	44,485	8,734,118	34,466,235	461,804	57,761,824	3,410,780	10,292,429	3,586,281	1,900,000	10,248,604	283,795,795
Unspent Budget Authority	$ 322,598	$ 2,856,133	$ 16,085	$ 148,199	$ 5,243,607	$ 99,255	$ 1,758,693	$ 433,390	$ 392,537	$ 824,294	$ 420,002	$ 3,793,285	$ 16,308,078
UNSPENT BUDGET AUTHORITY BY FUND													
General Fund	$ 321,612	$ 2,856,133	$ 16,085	$ 148,199					$ 368,484	$ 10,005	$ 420,002	$ 2,252	$ 4,142,772
State Special Revenue Fund									23,155	50,000			73,155
Federal Special Revenue Fund	986				$ 5,243,607	$ 99,255			898	764,289		3,791,033	9,900,068
Enterprise Fund							$ 1,758,693	$ 433,390					2,192,083
Unspent Budget Authority	$ 322,598	$ 2,856,133	$ 16,085	$ 148,199	$ 5,243,607	$ 99,255	$ 1,758,693	$ 433,390	$ 392,537	$ 824,294	$ 420,002	$ 3,793,285	$ 16,308,078

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

Office of the Commissioner of Higher Education
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2007

1. Summary of Significant Accounting Policies

Basis of Accounting

The office uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category. In applying the modified accrual basis, the office records:

- Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- Expenditures for valid obligations when the office incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the office to record the cost of employees' annual and sick leave when used or paid.

The office uses accrual basis accounting for its Proprietary and Fiduciary fund categories. Under the accrual basis, as defined by state accounting policy, the office records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the office receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The office uses the following funds:

Governmental Fund Category

- **General Fund** – to account for all financial resources except those required to be accounted for in another fund. This includes funds appropriated for general operations of the office and distributions to the university units and tribal and community colleges for their general operations.
- **State Special Revenue Fund** – to account for proceeds of specific revenue sources that are legally restricted to expenditures for specific state program

purposes. The majority of this activity is related to the mill levy distributions to the university units.

- **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Office Federal Special Revenue Funds include the Federal Family Education Loan Program (FFELP), the Vocational Education – Basic Grants to States grant, the Talent Search grant, and the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) award.

Proprietary Fund Category

- **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. Office Enterprise Funds include the MUS Group Insurance Program, the MUS Worker's Compensation Program, and Montana State Fund Scholarships.

Fiduciary Fund Category

- **Agency Fund** – to account for resources held by the state in a custodial capacity. Office agency funds include college license plates, optional retirement funds, and Guaranteed Student Loan collections.

2. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The office has authority to pay obligations from the statewide General Fund within its appropriation limits. The office expends cash or other assets from the statewide fund when it pays General Fund obligations. The office's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund balances for each of the fiscal years ended June 30, 2007, and June 30, 2006.

3. Direct Entries to Fund Balance

Chapter 607, Laws of 2005, appropriated General Fund monies to the office for distribution to the units of the university system, the community colleges, and the tribal colleges. The funding for this activity is shown in the General Fund as Direct Entries to Fund Balance on the Schedules of Changes in Fund Balances, and the expenditure is shown as Intra-Entity Expense in the Appropriations Distribution Program, Local Assistance from State Sources in the Community College Assistance Program, and Grants from State Sources in the Tribal College Assistance Program on the Schedules of Total Expenditures & Transfers-Out.

Section 20-25-423, MCA, levies property taxes to support, maintain, and improve the MUS. The state treasurer collects university property tax revenue and records it in a shared State Special Revenue Fund between the office and the Department of Revenue. These collections appear on the Schedules of Changes in Fund Balances as Direct Entries to Fund Balance in the State Special Revenue Fund totaling $15,097,053 and $13,955,858 in fiscal years 2006-07 and 2005-06, respectively.

4. Montana Family Education Savings Program

The schedules do not reflect the activity related to the Montana Family Education Savings Program (MFESP). As of June 30, 2006, the office had not recorded the MFESP on the state's accounting records. Office personnel did record the MFESP assets and Property Held in Trust on the state's accounting records in a Private-Purpose Trust Fund as of June 30, 2007. Due to the method used by the office to record the MFESP assets, the Private-Purpose Trust Fund is not reflected on the Schedule of Changes in Fund Balances and Property Held in Trust for the fiscal year ended June 30, 2007, and the Private-Purpose Trust Fund balance is understated by $205,558,491 at June 30, 2007. As of August 2007, the detail of contributions and distributions made and interest earned during fiscal years 2005-06 and 2006-07, as well as the value of the assets at June 30, 2006, was not available.

5. Charges for Services Revenue Estimate

Budgeted Revenues and Transfers-In were overestimated by $20,422,152 for the Charges for Services revenue classification in the Federal Special Revenue Fund in fiscal year 2005-06. This revenue estimate is related to the Montana Guaranteed Student Loan Program (MGSLP) activity. The MGSLP receives administrative cost reimbursements for the loan servicing activities performed. The amount of administrative cost reimbursements can be difficult to project because it largely depends on the volume of student loans that default, require servicing, and eventually are rehabilitated.

6. Subgrant Revenue Classification

The office receives federal subgrant financial assistance from the Montana Department of Labor and Industry. In fiscal year 2005-06, this activity was recorded within the Federal revenue classification. This activity should have been recorded as an Operating Transfers-In within the Other Financing Sources revenue classification. The Federal revenue classification is overstated, and the Other Financing Sources revenue classification is understated, by $222,807 on the Schedule of Total Revenues & Transfers-In for the fiscal year ended June 30, 2006.

7. Related Party Transactions

The Montana Guaranteed Student Loan Program (MGSLP) guarantees loans owned by the Montana Higher Education Student Assistance Corporation (MHESAC). The Board of Regents of Higher Education and MHESAC have three common board members.

MGSLP and MHESAC had lease agreements with Lewis and Clark County for the building in which they were located in fiscal years 2006-07 and 2005-06. MGSLP had an agreement with MHESAC to share certain costs associated with the building.

MGSLP has an agreement with Student Assistance Foundation (SAF) for the lease of computer equipment and the supplies and personal services related to the computer system. The office paid SAF $487,952 and $401,664 in fiscal years 2006-07 and 2005-06, respectively.

Certain employees of the Montana University System provide services to the MUS Workers' Compensation Program at no charge. The value of such services has not been determined.

Office of the Commissioner of Higher Education

Office Response

MONTANA UNIVERSITY SYSTEM
Office of the Commissioner of Higher Education

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October 11, 2007

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
State Capitol, Room 135
P.O. Box 201705
Helena MT 59620-1705

Dear Mr. Seacat:

Enclosed you will find the Office of the Commissioner of Higher Education's response to the recommendations presented in our Financial-Compliance audit for the two fiscal years ended June 30, 2007.

You will note that our responses to two of the recommendations have already been implemented. For two other recommendations we concur but must await either the federal approval process or investment maturities to implement the recommendations.

With all due respect, we strongly disagree with the first recommendation related to the Group Insurance Plan reserves. As our response indicates, we firmly believe we are complying with both state statutes and federal requirements, as well as adhering to the fiduciary responsibilities we have to our employees and their dependents to maintain our benefits plan on an actuarially sound basis and to maintain sufficient reserves.

We thank you and your audit team for the efforts made to improve the accuracy of the Office of the Commissioner of Higher Education's financial reporting and to ensure compliance with state and federal requirements.

Sincerely,

Sheila M. Stearns

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Commissioner of Higher Education

Recommendation #1

B-4 **We recommend the office maintain the Group Insurance Plan Reserve based on sound actuarial principles or other applicable criteria in accordance with federal regulations.**

Response:

Do Not Concur. The Montana University System (MUS) disagrees with language in the report and recommendation that a portion of the plan reserve may be unallowable under federal law and that plan personnel are not qualified to address the sufficiency of the reserve. The plan contracts for certified actuarial services to assist with the management and oversight of the plan. Plan rates are set in close cooperation with the actuary to ensure the plan can cover the obligations of the plan, while considering how rates impact reserves and employee out-of-pocket exposure to the ever-rising costs of health care services. This process is appropriate to meet the requirements of state and federal law.

State law authorizes the MUS to "maintain reserves to liquidate the unrevealed claims liability and other liabilities of the plan" per section 20-25-1310(1)(b), MCA. Neither state nor federal law require that an actuary set the amount of the reserve; that is *by law* a plan function and the obligation of the Commissioner of Higher Education, following analysis and consultation with the Inter-Unit Benefits Advisory Committee, a statutory committee of 24 well-qualified campus executives and human resources and labor personnel.

Federal regulations require that reserve levels in excess of the amounts set by sound actuarial principles be "identified and justified" and that costs "be authorized or not prohibited under State or local laws or regulations." See 2 CFR Part 225 (OMB Circular A-87). A federal audit review board interpreting this federal regulation expressly ruled: "There is nothing in the cost principles or methodology for determining what a reasonable reserve level must be. . . the state as the administrator of the self-insurance plan . . . must be permitted some discretion in determining a reasonable reserve level . . . the determination of an appropriate reserve level for a self-insurance plan can be a highly complex decision . . . concerning a number of unknowns." *Alabama Dept. of Finance v. Dept. of HHS Division of Cost Allocation* (DCA), 1997. The plan maintains a justifiable reserve, based on numerous factors, such as the fact that we do not carry excess insurance, the skyrocketing costs of health care, the volatility of provider discounts, the potential for catastrophic claims, and other factors which were provided to the auditor.

Furthermore, the reserve amount questioned by the auditors is less than 5% of the total plan expenditures in fiscal 2006-07. Our analysis and documentation indicates the reserve level is reasonable when compared with the risks of administering a self-insured plan. Operating an insurance plan in accordance with actuarial principles is the minimum standard set by state and federal law; it is the bar below which the plan must not fall. The plan, while utilizing an actuary, must retain its responsibility and obligation to set the reserve at an amount we believe to be sufficient to pay plan obligations under our unique circumstances. Anything less would be irresponsible and could negatively impact the health insurance coverage of over 16,000 MUS employees, retirees, and their eligible dependents.

Recommendation #2

We recommend the office record the Montana Family Education Savings Program activity on its accounting records in accordance with generally accepted accounting principles.

Response:

Concur. The office's fiscal staff has been in communication with the Department of Administration (DOA) to ensure that the detail of contributions, distributions and interest earned for fiscal year 2006-07 are available for the necessary adjustments to the State's Comprehensive Annual Financial Report. The office also met with DOA's accounting staff to discuss future financial schedule presentation options. The office will continue to work with DOA to ensure the activity is presented properly.

Recommendation #3

We recommend the office:

- **A. Recover indirect costs to the fullest extent possible in accordance with state law.**
- **B. Record indirect cost recoveries in the appropriate fund and account in accordance with state law.**
- **C. Obtain approval from the Board of Regents prior to accepting grants that limit the office's ability to recover indirect costs in accordance with state law.**

Response:

A. Concur. The office will conduct a time study to ensure the unrestricted rate appropriately reflects office activity only. Expenses for the general oversight and administration of the Montana University System will be removed and, as a result, we expect the unrestricted rate will be reduced and implemented where appropriate.

B. Concur. We believe the office has complied with this recommendation. The office recorded indirect cost (IDC) recoveries in the funds from which the indirect costs were originally paid. When the office's budget was established, the general fund was reduced by an amount equal to the budgeted indirect cost recoveries. Based on the budget and, in order to have a balanced IDC pool fund, IDC expenditures were charged to the IDC pool fund and reimbursed from indirect cost recoveries. If the office would have deposited all reimbursements to the general fund, the IDC pool fund would have had no revenue to cover its expenditures and the only place the office could get the cash to cover these expenditures would be from the general fund – where these expenditures were originally charged.

C. Concur. The Board of Regents approves major grants accepted by the office. We will make the allowed indirect cost rate more explicit in our discussion with the Board.

Recommendation #4

We recommend the office pay the indirect costs of the Rural Physicians Incentive Program from the fees collected in accordance with state law.

Response:

Concur. The office has already implemented this recommendation. As of July 1, 2007, the costs of administering this program will be charged to the Rural Physicians Incentive State Special Revenue Account.

Recommendation #5

We recommend the office invest the GEAR UP funds with the Board of Investments in accordance with state law.

Response:

Concur. The office will move the investments to the Board of Investments as maturities allow. The investments would incur significant early withdrawal penalties if closed out prior to their maturity.

Recommendation #6

We recommend the office minimize the time between the draw of federal funds and their disbursement for federal program purposes as required by federal regulations.

Response:

Concur. The cash draws referred to in this recommendation are related to one grant from the Montana Department of Labor. The office has implemented cash management procedures for this grant that match the procedures used with other cash draws for all other major federal programs in the office. These cash management procedures are in compliance with federal regulations.

Disclosure Issue
MGSLP Resources used for Student Assistance Program

Section 20-26-1103(6), MCA, authorizes the Montana Guaranteed Student Loan Program (MGSLP) to perform "any other duties necessary for the administration of the student loan program and other student financial aid-related activities for the benefit of students as determined by the board." In addition to existing state law, the legislative branch acknowledges MGSLP's participation in the student assistance program and addresses this activity in the following language taken from page E-125 of the Legislative Fiscal Report-2009 biennium, "In addition to servicing loans, the program also provides counseling and assistance programs to students in an effort to prevent student loan defaults." The office has presented the expenditures for student assistance activity in accordance with state law. In addition, all spending on these activities has been approved by the Montana Board of Regents and has also been presented to numerous legislative committees. Activities such as GEAR UP, the MUS Honors scholarship program, and the Montana Family Education Savings Plan are all a part of MGSLP carrying out its duties as a guarantee agency under the Higher Education Act and the US Department of Education and as the administrator of the federal student loan program under that Board of Regents. Additionally, the federal regulations governing MGSLP, the Higher Education Reconciliation Act of 2005, specifically require MGSLP (as a guarantor) to be a conduit for early awareness and default prevention. The expenditures are reflected as regular, on-going costs to administer the program, which MGSLP believes to be appropriate under both state and federal law.

Expenditures of non-General Fund Money First

MGSLP must always have unspent budget authority or the student loan program is at risk. MGSLP makes every effort to accurately predict how much authority it will need, but it is impossible to calculate the specific amount of lender claims and the respective federal collection expense resulting from those claims. If MGSLP under-estimated the amount of authority, our ability to pay a lender claim or the federal portion of a defaulted loan recovery would be at risk – meaning our very program would be at risk.

Predicting how much budget authority we will need is difficult because our outstanding loan guarantee portfolio has grown by more than 100% over the last several years. As recently as last year, MGSLP's cohort default rate was in excess of 5%. As has been discussed previously during this audit, when MGSLP collects on a defaulted loan, roughly 75% of the collection amount is recorded as an expense. MGSLP anticipated an increase to its collection expenses resulting from our portfolio growth and the corresponding default rate. Fortunately, MGSLP has been successful in preventing many of the anticipated loan defaults.

To further complicate the accuracy of estimating our necessary budget authority, federal regulatory changes now limit our various types of collection recoveries. These regulatory changes make it considerably more difficult to predict collection expenses. Based on the uncertainty of the amount of claim payments each year, it is imperative that MGSLP has sufficient appropriation authority to reimburse the US Department of Education its required percentage of our collection recoveries. If we were to underestimate our budget authority and were unable to pay the Department, we would at best be out of compliance.

An important thing to note is that MGSLP's authority does not equate to cash on hand. If that were the case, it would still be inappropriate to spend the authority down for several reasons. Our federal operating fund has a reserve ratio requirement that must be maintained. If our reserve drops below the required level, a transfer of funds from the agency operating will be necessary to bring the reserve level into compliance. Additionally, management has made future financial obligations that will impact the balance in the agency operating fund, such as increased costs for our loan servicing system and HR2669 reductions to revenue and the elimination of exceptional performer status for lenders. Another critical reason for reserves is the need for additional funds for loan loss allowance.

MGSLP Fund Placement

We noted that the auditor has indicated that there is a conflict between sections 17-2-108(1) and 20-26-1105, MCA, which may need to be legislatively corrected and that about 25% of the MGSLP reserves cannot be placed in the federal special revenue fund, even though Section 20-26-1105 expressly states that "all money . . ." shall be deposited there. Montana law requires that, where there is an apparent conflict, the specific or particular statute shall govern over the general statute. See the following sections and Montana Supreme Court cases:

> Section 1-2-102, MCA: In the construction of a statute, the intention of the legislature is to be pursued if possible. When a general and particular provision are inconsistent, the latter is paramount to the former, so a particular intent will control a general one that is inconsistent with it.

Section 1-4-103, MCA: In the construction of an instrument, the intention of the parties is to be pursued if possible. When a general and particular provision are inconsistent, the later is paramount to the former so a particular intent will control and general one that is inconsistent with it.

Section 1-3-225, MCA: Particular expressions qualify those which are general.

Where there are two statutes, one of which deals with a subject in general terms and another in more detailed terms, the special statute controls the general statute to the extent of any inconsistency. *State v. Dept. of Public Service Regulation,* 181 Mont. 225, 592 P.2d 34 (1979).

Where several provisions would otherwise be inconsistent, a construction should be adopted that will give effect to all of them. *State ex rel. Nelson v. District Court,* 262 Mont. 70, 863 P.2d 1027, 50 St. Rep. 1447 (1993).

It is presumed that the legislature has not passed a meaningless statute, and statutes on the same subject must be harmonized to give effect to both. *Montana Contractors' Assn. v. Dept. of Highways,* 220 Mont. 392, 715 P.2d 1056, 43 St. Rep. 470 (1986).

The rules of statutory construction require the language of a statute to be construed according to its plain meaning. If the language is clear and unambiguous, no further interpretation is necessary. *Lovell v. St. Comp. Mut. Ins. Fund,* 260 Mont. 279, 860 P.2d 95, 50 St. Rep. 1043 (1993); *State v.* Zabawa, 279 Mont. 307, 928 P.2d 151, 53 St. Rep. 1162 (1996).

The language of section 20-26-1105, MCA, is clear and unambiguous, and it is clearly the more specific statute. We believe recording revenue generated by MGSLP's operations in a federal special revenue fund is appropriate. The revenue recorded in the fund is for repayment of assets purchased with federal funds. The repayment is a product of participating in the Federal Family Education Loan Program. As stated in the disclosure language, section 20-26-1105, MCA, directs the Board of Regents to credit all money designated for the student loan program to the student loan account in the federal special revenue fund. This statute speaks specifically to the student loan program versus the overall fund structure established in 17-2-102, MCA.